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Commission on Taxation

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Environmental Tax

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 - Commission recommendation to introduce a carbon tax
 - What will the tax apply to?
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Carbon tax

Background

In recent years, the Irish Government has announced a number of environmental-based initiatives including tax, grants, and energy efficiency incentives. Ireland has committed to reducing its greenhouse gas (GHG) emissions by 20% of 2005 levels by 2020 under the terms of the EU Climate Action and Renewable Energy Package 2008. Ireland has also committed to sourcing 40% of energy requirements from renewable sources by 2020 under the Government's White Paper on Renewable Energy Targets. Policy initiatives are required if we are to meet this target. The idea of introducing a carbon tax in Ireland was noted in the Programme for Government 2007 – 2012, and has received much media coverage since.

Ireland has an annual average GHG emissions target of 62.8m tonnes up to 2012. The Report comments that we are producing approximately 25% in excess of this. The source of Irish GHG emissions levels in 2007 were:

Carbon dioxide	68.13%
Methane	19.00%
Nitrous oxide	11.84%
F gases	1.03% combined

The combustion of fossil fuels remains the largest source of carbon dioxide emissions. Fossil fuels include peat, coal, gas and oil. Ireland is heavily dependent on fossil fuels, accounting for 96% of all energy use in Ireland in 2007. Once developed, energy generated from wind, wave and solar technology is carbon neutral. This has led to a number of tax based incentives to promote these as alternative energy sources.

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Commission recommendation to introduce a carbon tax

It is against this background that the Commission was asked to consider “fiscal measures to protect and enhance the environment including the introduction of a carbon tax.” A number of other EU member states have already introduced carbon tax type regimes, including Denmark and Sweden.

Adopting the “polluter pays” principle, the Report recommends the introduction of a carbon tax based on the carbon content of fossil fuels consumed within Ireland. One of the primary aims of the tax will be to incentivise a move to alternative energy sources and hence act as a tool in driving climate change. While liberalisation of the electricity retail market will facilitate moves to carbon free neutral sources, a full market transition is not feasible.

What will the tax apply to?

The Report recommends that a carbon tax should apply to peat, coal, oil, auto fuel, LPG and natural gas consumed

within Ireland, for example oil that is burnt or used in a manufacturing process in Ireland. The collection mechanism is to mirror that applying to excise duties on mineral oils.

New arrangements would need to be introduced for those fuels which are currently not subject to excise duties (peat and natural gas) and for fuels for which there is a specific exemption from excise duties, for example diesel used on international air-routes.

The Report recommends that the tax would apply to imports of fossil fuels, which are then consumed in Ireland. The tax would not apply to exports of fossil fuels from Ireland.

Interaction with EU Emissions Trading Scheme (ETS)

It is recommended that the carbon tax would not apply to Irish companies which already operate within the ETS. Under the EU ETS each Member State has been given a limit on carbon dioxide emissions for the industries covered by the scheme. Each installation gets a carbon allowance

which must be compared to the actual emissions for a period. If the installation’s actual emissions exceed those permitted, additional allowances must be purchased from those operators who have excess allowances remaining. There are approximately 70 companies in Ireland operating with the EU ETS system in industries such as power generation and pharmaceuticals. If these companies are excluded from the carbon tax regime, on perhaps an initial basis until the current ETS regime expires in 2012, the initial impact on consumers will be reduced.

Single rate

The Report states that one single rate of carbon tax should apply across all sectors of the economy. However, it recommends that companies with binding emissions reduction targets with Sustainable Energy Ireland are accommodated.

Calculation of carbon tax

The tax would be based on the estimated amounts of carbon dioxide emitted from these energy sources

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when they are consumed. It will be necessary to convert each fuel source to a comparable measure of carbon dioxide emission before the tax can be levied. The Report states that the internationally agreed standard for comparing the amounts of carbon dioxide emitted by different fuels is the ton of oil equivalent (TOE). When the fuel sources are converted to this TOE, a uniform carbon price can then be applied. For example, peat and coal have the highest TOE and hence will attract a higher level of carbon tax. Natural gas has the lowest TOE.

In terms of pricing, it is recommended that the tax be calculated by reference to the carbon price for trading under the EU ETS. A floor price is also advised with a suggestion of €20 per tonne. As the carbon price fluctuates on a daily basis under the ETS regime, it is advised that the carbon price for the purposes of calculating carbon tax be set at the price in the futures market for the next calendar year. This is currently €15.33.

The report estimates that, at a price of €20 per tonne, the following carbon tax levels would apply:

Petrol (per litre)	€0.047
Auto diesel (per litre)	€0.054
Natural gas (kwh)	€0.004
Light Fuel Oil (per litre)	€0.05367
Briquettes (per bale)	€0.48
Coal (per tonne)	€56.32

It is projected that a carbon tax, if imposed at this level, would raise additional tax revenues in the region of €480m in 2010.

How will the tax be collected?

The Report proposes that the tax be collected at the earliest point of supply in Ireland. It is envisaged that this will be the only revenue collection point so that the cost of the tax will be subsumed into the cost of supply/production in a manner mirroring the excise duty system. The tax will then be passed down through the supply chain to the final consumer. The Report does not prescribe any reporting obligations along the various stages of production.

One would, however, assume that there will be an onus on the supplier

to determine whether or not carbon tax is to be charged, for example if the purchaser is an ETS company. Documentary evidence to support this will probably be required, perhaps similar to the VAT Section 13A procedure.

The Report recommends using the existing mineral oils excise duty system for collecting the tax. Currently, excise duties on fuels are paid on a daily basis. As there is currently no deferred payment mechanism for excise duties on mineral oils, if this were to apply to carbon tax it would further increase cash flow difficulties for administrators of the regime and represent challenges for businesses which are not familiar with this scheme.

A visible tax

The Report recommends that the tax should be visible to the final consumer if the tax is to achieve its desired “behavioural change” objectives. While the Report does not detail how this would be achieved, what is probably envisaged is something akin to the plastic bag levy where the amount charged by the retail outlet is shown as

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a separate item on the till receipt given to the customer.

The Report also does not consider the interaction between carbon tax and VAT. Bearing in mind that the carbon tax will be included in the cost of supply from the point of first consumption, it is likely for ease of administration that VAT will be levied on the carbon tax inclusive price thereby increasing the VAT burden for final consumers.

Additional cost?

The major issue for business will be to assess the potential impact on their costs arising from the introduction of the carbon tax, and its interaction with the ETS.

Funding of local government

The Commission was asked to consider the financing of local government, and considered commercial rates (dealt with under Property tax below), and water and waste charges.

Water charges

The cost of providing water services is increasing. The Report states that there was a gap of €394m between water charge income and water expenditure in 2007. Local Authorities currently levy water charges on business and commercial operators. Domestic homes are exempt. The Report states that the non-domestic sector cost recovery rate is only 73%.

The Report recommends:

- that non-domestic sector charges be increased to full cost recovery.
- the introduction of water charges for domestic homes. While it is recommended that this would initially be on a flat rate basis, a move to a volume based charge is envisaged over time. Ultimately full cost recovery for the domestic sector is recommended. Meters would need to be placed in homes. The Report recommends some level of incentivisation to encourage consumers to install meters in existing homes.

The introduction of water charges for domestic homes will be a very sensitive issue and in this regard the Report refers to a possible waiver for low income households.

Waste charges

The Report notes that cost recovery for local authorities on provision of waste facilities is in the region of 80%.

The Report recommends that:

- all consumers should pay for their own waste and that full cost recovery should be achieved.
- the current landfill levy of €20 per tonne be increased to divert waste away from landfill sites.
- income tax relief on service charges be abolished on the basis that it dilutes the “polluter pays” principle.
- waivers should be made available by all waste service providers, including private operators, for consumers who lack an ability to pay.

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Existing tax reliefs

Notwithstanding the increases in costs and administration which will arise on the introduction of the above measures, companies should bear in mind that there are a number of existing tax reliefs which could be availed of to mitigate the cost of these environmental charges.

These include:

- the Energy Efficient Capital Allowance Scheme, where companies can avail of 100% capital allowances in the year in which the expenditure is incurred on approved energy efficient plant and equipment.
- the capital allowance scheme for motor cars has been modified to favour cars with lower energy consumption and emissions.

- the allowance of leasing charges on business cars has also been linked to the carbon emissions levels of cars.
- tax relief is available for investment into renewable energy generation in the areas of solar, wind, and hydro power as well as biomass.
- the BES and SCS schemes have been extended to include investment in recycling companies which have IDA grant aid.
- the VRT system has been changed to link VRT rates to the emissions levels of cars.

The Report recommends that these measures be continued and that the accelerated capital allowances regime be extended to incentivise innovation.

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The Global Tax Monitor recognises PricewaterhouseCoopers as one of the leading firms in Ireland for tax advice by reputation.

These results are based on the year-ending Q2 2009 figures, with a sample size of 100 primary buyers of tax advice in Ireland.

Launched in 2000, the Global Tax Monitor (GTM) is a multi-client independent survey conducted by research agency TNS, that examines the competitive position of the top firms in the tax advisory market - globally, regionally, nationally and on an industry basis. It provides a comprehensive measure of firm reputation, client service and brand health, gained currently from just over 3,000 telephone interviews annually with key decision makers (CFOs and Tax Directors) in 31 key markets.

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